LEGISLATIVE PROPOSAL 05-23
EXECUTIVE SUMMARY

- **Title:** Establish A Statute Of Limitations On Collections To Extinguish Uncollectible Debts

- **Problem Statement:**

  Current state law lacks a statute of limitations for the collection of delinquent taxpayer accounts by FTB, resulting in the following problems:
  - Written contacts, including amnesty invitations, made with respect to very old collection balances cause distress for taxpayers that believe their account is current.
  - Records regarding these old liabilities frequently no longer exist, making proof of what actually occurred difficult.
  - Delinquent balances—even those determined by the department to be uncollectible—are required to be carried on FTB's books indefinitely as accounts receivable, which is a misleading portrayal of amounts owed to the state.

- **Proposed Solution:**

  Establish a statute of limitations on collections that sets the period during which tax may be collected to the period that expires 20 years from the last statutory lien date for each tax year. After that date the liability for the tax year would be extinguished by abating the underlying tax.

- **Major Concerns/Issues:**

  This proposal provides that delinquent balances would become uncollectible by reason of lapse of time and would thereafter be "abated." These abated balances could give rise to income from the discharge of indebtedness. A discharged debt is generally considered income subject to tax under both federal and California law.

- **Revenue:**

  The revenue loss from this proposal is as follows:

Estimated Revenue Impact For a 20-Year SOL on Collections Assumed Enactment After June 30, 2005 (in millions)		
2005-06	2006-07	2007-08
-$2	-$2	-$2

- **Proposed By:** Franchise Tax Board

2005 Departmental Legislative Proposal
LP 05-23

Title

Establish A Statute Of Limitations On Collections To Extinguish Uncollectible Debts

Introduction

This proposal would establish a 20-year statute of limitations to collect income or franchise tax balances due from taxpayers, and thereafter extinguish the liability to pay such balances by abating the tax.

Program History/Background

As a result of Franchise Tax Board's (FTB's) current practices, including its automated collection system, virtually all tax delinquencies remain subject to collection until full payment is made.

FTB currently uses an automated billing/collection system to collect the majority of its delinquent accounts. Taxpayers with tax delinquencies receive one or more notices informing them of the balance due and that collection actions may occur if the balance is not resolved. Collection actions include, but are not limited to, attaching bank accounts, garnishing wages, or filing a Notice of State Tax Lien with the county recorder. Liens are effective for 10 years from the date recorded and, if the liability meets the criteria established by the department, may be extended for an additional 10 years. FTB routinely issues Notices of State Tax Liens on both individual and business entity accounts.

Once FTB determines that an account is currently or permanently uncollectible, the department may be discharged from collection accountability with respect to that account pursuant to the Government Code. When a liability is placed in discharge status, the debt still exists; however, generally no additional notices are sent to the taxpayer regarding that liability unless new address or asset information is obtained. In addition, if there is an overpayment of tax from another tax year, the overpayment is applied against the discharged delinquency before any remaining overpayment is refunded.

In conjunction with the recent general amnesty program, 1.7 million letters were mailed to taxpayers urging their participation in the program. Many of these letters related to very old balances due for which the department had been absolved from collecting, although the debts continued to exist.

Current Federal and State Law

Under both federal and state income tax laws, in general, once a tax liability becomes due and payable, a statutory lien arises for that amount upon all real and personal property belonging to that taxpayer. For federal purposes, this statutory tax lien exists as long as the delinquency exists or until it is unenforceable by reason of lapse of time. For state purposes, the statutory lien exists for 10 years, but does not become unenforceable by lapse of time. The expiration of the statutory lien does not extinguish or abate the underlying tax liability. The statutory lien may be extended by filing a Notice of State Tax Lien with the county recorder within 10 years from the date the statutory lien is created. A notice of federal or state tax lien may be recorded or filed as provided by law.

Under federal law, the IRS is precluded from taking any collection action 10 years after the assessment of tax, unless the taxpayer agrees to waive this period of limitation. The 10-year limitation on collection is extended or suspended under a number of circumstances, such as bankruptcy actions, installment agreements, offers in compromise, wrongful levies, or pending court actions. The federal 10-year limitation applies to all taxpayers.

Under current state law, there is no statute of limitations on the collection of an income or franchise tax delinquency.

Problem

Current state law lacks a statute of limitations for the collection of delinquent taxpayer accounts by FTB, resulting in the following problems:

- Written contacts, including amnesty invitations, made with respect to very old collection balances cause distress for a taxpayer that believes their account is current.
- Records regarding old liabilities frequently no longer exist, making proof of what actually occurred difficult.
- Delinquent balances—even those determined by the department to be uncollectible—are required to be carried on FTB's books indefinitely as accounts receivable, which is a misleading portrayal of amounts owed to the state.

Proposed Solution

Establish a statute of limitations on collections that sets the period during which tax may be collected to the period that expires 20 years from the last statutory lien date for each tax year. After that date, the liability for the tax year would be extinguished by abating the underlying tax.

Effective/Operative Date of Solution

Assuming enactment in 2005, the proposal would be effective on January 1, 2006, and would be applied on and after July 1, 2006, to tax liabilities that are due and payable, as defined, before, on, and after that date.

Justification

The proposed 20-year limitations period on collections would result in a more accurate representation of FTB's accounts receivable balance. Providing a statute of limitations would also move California closer to current federal law, which provides for a 10-year statute of limitations for collections. In addition, because this solution would abate all previously discharged balances that are already beyond the proposed 20-year collection period, such balances would not be subject to the amnesty penalty.

Implementation

Implementing this proposal would not significantly impact the department's programs or operations.

Fiscal Impact

The cost to implement this proposal is approximately $1.7 million for systems design, programming, testing, and related system startup costs.

Economic Impact

Revenue Estimate

Based on the assumptions and data discussed below, the revenue loss from this proposal is as follows:

Estimated Revenue Impact For a 20-Year SOL on Collections Assumed Enactment After June 30, 2005 (in millions)		
2005-06	2006-07	2007-08
-$2	-$2	-$2

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.
Revenue Discussion

The amount of taxes, additions to tax, penalties, fees, and interest determined to be beyond the proposed 20-year SOL that would have been otherwise collected would determine the revenue impact of this bill. Based on collection data, it is estimated that this provision would result in revenue losses of roughly $2 million annually.

Policy Considerations

- California currently does not conform to the federal 10-year statute of limitations on collections. This proposal would move California in the direction of conformity. However, this proposal is significantly different from the federal law. Most notably, this proposal would establish a 20-year limitations period for collections, in comparison to the federal 10-year period. This proposal would also extinguish the actual taxpayer debt by abating the tax. Federal law is a bar to further collection activity by IRS after 10 years.

- It is not unusual for final federal determinations to take many years to resolve and become final, particularly for tax shelter or other complex issues involving partnerships. FTB may not become aware of such determinations until after the expiration of the collections limitations period under this proposal. As such, any liabilities previously extinguished by reason of lapse of time would not be “revived” when FTB proposes a deficiency assessment based on a final federal determination. However, any new California final liability resulting from the federal determination occurring before the expiration of the 20-year period would restart the period of collection for the total liability for the tax year.

- For taxpayers that have not filed a return, FTB has an unlimited amount of time to mail notices of proposed deficiency assessment. Under this proposal, liabilities attributable to assessments issued to nonfilers under FTB’s filing enforcement program would be extinguished by reason of lapse of time. This could have the unintentional effect of creating limitations period when deficiency assessments are issued to nonfilers. For example, FTB issued a notice of proposed assessment to a nonfiler based on third party information. After 20 years, the resulting liability becomes uncollectable and is extinguished by lapse of time. After that lapse of time the taxpayer files a return including the income upon which the notice was based and pays the tax. Under this proposal, FTB may be required to refund the payment as uncollectible. The collections limitation period would not apply in the case of nonfilers that have not been mailed notices of proposed assessment.

- This proposal provides that delinquent balances would become uncollectible by reason of lapse of time and would thereafter be "abated." These abated balances could give rise to income from the discharge of indebtedness. A discharged debt is generally considered income subject to tax under both federal and California law.

Other States

Six of the larger states with tax laws similar to California's were reviewed. The period for collection for each of these states is noted in the table below. It does not appear that any of these states have a provision to expressly extinguish or abate a balance that has become uncollectible by reason of lapse of time.

State	*Florida*	*Illinois*	*Massachusetts*	*Michigan*	*Minnesota*	*New York*
Period	20 years	20 years	6 years	No SOL	5 years	6 years

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FRANCHISE TAX BOARD
PROPOSED AMENDMENTS TO LP05-23

AMENDMENT 1

Section 1. Section 19255 is added to the Revenue and Taxation Code, to read:

19255. (a) Except as otherwise provided in subdivisions (b) and (e), after twenty years has lapsed from the date the latest tax liability for a taxable year or the date any other liability not associated with a taxable year became “due and payable” within the meaning of Section 19221, the Franchise Tax Board may not collect that amount and the taxpayer’s liability to the state for that liability is abated by reason of lapse of time. Any actions taken by the Franchise Tax Board to collect an uncollectible liability shall be released, withdrawn or otherwise terminated by the Franchise Tax Board and no subsequent administrative or civil action shall be taken or brought to collect all or part of that uncollectible amount. Any amounts received in contravention of this section shall be considered an overpayment pursuant to Section 19306 that may be credited and refunded in accordance with Section 19301.

(b) If a timely civil action pursuant to Article 2 of Chapter 6 of this part is commenced, or a claim filed in a probate action, the period for which the liability is collectable shall be extended and shall not expire until that liability, probate claim, or judgment against the taxpayer arising from that liability is satisfied or becomes unenforceable under the laws applicable to the enforcement of civil judgments.

(c) For purposes of this section:

(1) “Tax liability” means a liability imposed under Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001, or this part and includes any additions to tax, interest, penalties, fees and any other amounts relating to the imposed liability.

(2) If more than one liability is “due and payable” for a particular taxable year, the “due and payable” date that is later in time shall be the date upon which the twenty-year limitation of subdivision (a) commences.

(3) The Franchise Tax Board shall permanently remove from its financial records the amounts for which liability has been abated pursuant to subdivision (a).

(d) This section shall not apply to amounts subject to collection by the Franchise Tax Board pursuant to Article 5, 5.5 or 6 of this chapter, or any other amount that is not a tax imposed under Part 10 or Part 11, but which the Franchise Tax Board is collecting as though it were a final personal income tax delinquency.

(e)(1) The expiration of the period of limitation on collection under this section shall be suspended for the following periods:

(A) The period that the Franchise Tax Board is prohibited from involuntary collection under subparagraph (B) of paragraph (1) of subdivision (b) of Section 19271 (relating to collection of child support delinquencies), plus 60 days thereafter.

(B) The period during which the Franchise Tax Board is prohibited by reason of a bankruptcy case from collecting, plus six months thereafter.

(C) The period described under subdivision (d) of Section 19008 relating to installment payment agreements.

(D) The period during which collection is postponed by operation of law under Section 18571, related to postponement by reason of service in a combat zone, or under Section 18572, related to postponement by reason of Presidentially declared disaster or terroristic or military action.

(E) During any other period during which collection of a tax is suspended, postponed, or extended by operation of law.

(2) A suspension of the period of limitation under this subdivision shall apply with respect to both parties of any liability that is joint and several.

(f) This section shall be applied on and after July 1, 2006, to any liability “due and payable” before, on or after that date.